IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 94.

MOTHER LODE COALITION MINES COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR THE PETITIONER.

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CITATIONS

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OPINION BELOW.

The opinion of the Circuit Court of Appeals (R. 85-90) is recorded in 125 F. (2d) 625-27. The findings of fact and opinion of the Board of Tax Appeals (R. 11-20) are recorded in 42 B. T. A. 596.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered February 21, 1942 (R. 90-91). The petition for a writ of certiorari was filed May 19, 1942, and was granted on June 8, 1942, limited to the first question stated in the Government's memorandum (R. 91). A petition requesting that the writ be granted without limitation was denied

October 19, 1942. The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

In its income tax return for 1934, the petitioner reported a net loss from its copper mining property without any allowance for depletion. In its income tax return for the year 1935, it reported net income from the property after an allowance for percentage depletion. Which of these two returns is the "first return" made by the taxpayer under Section 114 (b) (4) of the Revenue Act of 1934?

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved will be found in the Appendix, *infra*, pp. 19-22.

STATEMENT.

The petitioner is a corporation engaged in the business of mining and selling copper from its copper mining property located near Kennecott, Alaska. The mine was acquired in 1919 (R. 12).

Prior to the effective date of the Revenue Act of 1932, the allowance for depletion for metal mines had been computed solely upon the basis of cost or discovery value. That Act introduced a new method of computing depletion, based upon a percentage of income. Taxpayers were directed to state in their returns for 1933 whether they elected to have the depletion allowance for their property for succeeding taxable years computed with or without reference to percentage depletion. The petitioner had already exhausted its cost depletion in 1925 (R. 12, 15, 47). In its income tax return for 1933, it therefore elected percentage depletion "for the year 1933 and thereafter." (R. 13).

During the year 1934, the mine was shut down, and the petitioner stopped all mining operations. It did, however, sell certain copper which had been mined in prior years

(R. 12). Its income tax return for 1934 showed a net loss of $38,898.26 without any allowance for depletion. The treasurer of the petitioner, who had prepared the return, believed that it was not entitled to any deduction for percentage depletion for 1934 because it had no net income that year (R. 14, 45). Moreover, he considered the election made in the 1933 return still binding (R. 14). Consequently, he thought it unnecessary to make any reference to percentage depletion in the 1934 return.

In 1935 the petitioner reopened the mine, resumed mining operations and reported a net income of $63,466.00 for the year after a deduction of $25,276.88 for percentage depletion (R. 11-12). The 1935 return contained the following statement (R. 12):

> "Under the provisions of Section 114 (b) (4) of the Revenue Act of 1932, the taxpayer elected to deduct depletion on the percentage basis for the year 1933 and thereafter."

The 1935 return was reviewed, and a report made by the Internal Revenue Agent dated December 31, 1936, which made no change in the petitioner's deduction for percentage depletion (R. 67-73). More than two years later, a second Agent's report disallowed the deduction (R. 14, 76), and the Commissioner thereupon determined a deficiency in the amount of $3,475.57 (R. 6-7). The Board of Tax Appeals sustained that determination (R. 20). The Circuit Court of Appeals for the Second Circuit affirmed (R. 90). That court held that, despite the election in the 1933 return under the 1932 Act, the petitioner was required to make a fresh election under the 1934 Act and, moreover, that the petitioner was required to state that election in its 1934 return (R. 86-90). On June 8, 1942, this Court granted the petition for a writ of certiorari, "limited to the first question stated in the Government's memorandum. . . ." (R. 90). A petition praying the Court to reconsider its order and to issue a writ of certiorari without limitation as to scope, was denied on October 19, 1942.

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals erred:

1. In holding that under Section 114 (b) (4) of the Revenue Act of 1934 the petitioner was required to state its election of percentage depletion in the 1934 return.

2. In failing to hold that petitioner's original return for 1935 was the "first return" under the Revenue Act of 1934 within the definition of Section 114 (b) (4) of that Act.

3. In holding that petitioner was not entitled to a deduction for percentage depletion for the year 1935.

4. In affirming the order of the Board of Tax Appeals.

SUMMARY OF ARGUMENT.

A.

We insist that the petitioner's "first return" within the meaning of Section 114 (b) (4) of the Revenue Act of 1934 was its return for 1935, in which it reported net income for the first time after the enactment of that statute. Every word in that section must be given meaning, and when that is done, the "first return" must necessarily be the first in which the taxpayer has an election between cost and percentage depletion. Not until that return can he state his election to have "the depletion allowance for such property for the taxable year for which the return is made" computed with or without regard to percentage depletion. Not until that return can the statutory words "the depletion allowance . . . for such year shall be computed according to the election thus made" be given effect. This construction accords with this court's settled rules of statutory construction, and gives effect to the obvious purpose of Congress. It is squarely supported by *Pittston-Duryea Coal Co.* v. *Commissioner*, 117 F. (2d) 436, (C. C. A. 3d), and by the latest views of the Board of Tax Appeals.

B.

The administrative construction of Section 114 (b) (4), which apparently makes the existence of gross income the test of "first return", is entitled to no weight. First, the statute is unambiguous, and administrative construction is unnecessary and ineffective. Second, the Commissioner's regulation is clearly contrary to the intendment of Congress. That intendment is demonstrated, not only by the statutory language, but also by the action of Congress in amending Section 114 (b) (4) when its attention was drawn to the regulation by court decisions. The unmistakable purpose of the change was to clarify the original intent which had been ignored by the Commissioner.

ARGUMENT.

Petitioner's Return for 1935 was the "First Return" Within the Meaning of Section 114 (b) (4) of the Revenue Act of 1934.

The problem in this case is simple: What was the "first return" within the meaning of Section 114 (b) (4) of the Revenue Act of 1934 (*infra*, pp. 19-20)?

We say that the 1935 return was the "first return" because it was the first under the 1934 Act in which the taxpayer reported net income and thus had an election to make a statement as to any form of depletion and make a computation pursuant thereto. The Commissioner has taken the position that the 1934 return was the first because it showed items of gross income and deductions "in respect of a property." The lower court sustained the Commissioner, apparently because he had set forth this view of Section 114 (b) (4) in the Treasury Regulations for the Act of 1934. (Reg. 86, Art. 23 (m)-5.)

The vice of the Commissioner's and lower court's construction is that it fails to give any effect whatever to a very large portion of Section 114 (b) (4). The clause "making his first return under this title in respect of a

property," upon which both rely, is not a discrete grammatical entity, but rather an integral part of both the sentence and the section in which it appears. More than that, both the Commissioner and the court below gave no effect to the obvious purpose of Congress in enacting Section 114 (b) (4). If, as we believe, the Treasury Regulation is patently contrary to the intention of Congress, it can add nothing to the Commissioner's position and should have been disregarded by the lower court.

A. The "first return" in section 114 (b) (4) means the first return in which the taxpayer is entitled to a depletion allowance.

The lower court to the contrary notwithstanding, we do not seek to add anything new to Section 114 (b) (4). Rather, we urge simply that the Court apply well settled principles of statutory construction and accord every word in the statute the meaning it had for Congress. If that be done, there can be no doubt that the "first return" is the 1935 return.

It is elementary, of course, that in the construction of Federal statutes the intent of Congress is paramount. *United States* v. *American Trucking Association*, 310 U. S. 534, 542; *Federal Communications Commission* v. *Columbia Broadcasting System*, 311 U. S. 132, 135. Everything else is subordinate. Moreover, that intent is not to be gleaned from dissociated words or clauses; the whole of the statute, and of necessity the whole of the particular section involved, is to be given full weight. *Helvering* v. *New York Trust Co.*, 292 U. S. 455, 463; *Perrine* v. *Chesapeake & Delaware Canal Co.*, 9 How. 172, 190; *Brown* v. *Duchesne*, 19 How. 183, 194; *Heydenfeldt* v. *Daney Gold and Silver Mining Co.*, 93 U. S. 634, 638; *D. Ginsberg & Sons* v. *Popkin*, 285 U. S. 204, 208.

This principle the Commissioner's interpretation of Section 114 (b) (4) ignores. The Commissioner emphasizes the words "first return . . . in respect of a property" to

the apparent exclusion of everything else in the section. Not only does he overlook their function in the scheme of Section 114 (b) (4) but he seems even to disregard their relation to the remainder of the sentence in which they appear.

Section 114 (b) (4) of the 1934 Act provides that a—

> "Taxpayer making his first return under this title in respect of a property shall state whether he elects to have *the depletion allowance for such property for the taxable year for which the return is made computed* with or without regard to percentage depletion, *and the depletion allowance in respect of such property for such year shall be computed* according to the election thus made." (Italics supplied).

When that sentence is read as a whole, it is plainly not enough that a return be "in respect of a property" in order to be a "first return", nor is it sufficient that it shows items of gross income and deductions. As the italicized portions of the above quotation show, the "first return", to fit the entire sentence, must be a return in which the taxpayer can elect to have the depletion allowance "for the taxable year for which the return is made *computed*" on the cost or percentage basis, and a return which allows effect to be given to the provision that the depletion allowance "for such year *shall be computed*" according to the election thus made. Each of these requirements must be met. That is why they are contained in the Act.

Such being the language of the sentence, we submit that a return does not become a "first return" under the Act simply because it is "in respect of a property"[1] and shows items of gross income and deductions. The statute clearly means by "first return" the return for the first year after December 31, 1933, in which an election is possible, and in which, by the same token, a computation of depletion can

[1] The phrase "in respect of a property" obviously includes a metal mining property, as the Circuit Court of Appeals held (R. 88).

and shall be made. Viewed realistically, the election is between cost and percentage depletion. But none can be made in a taxable year in which the taxpayer can take neither cost nor percentage depletion. Certainly the return for such a year is not one in which the taxpayer can elect to have "the depletion allowance . . . for the taxable year for which the return is made" computed in any particular way—that is, with or without regard to a percentage basis. Items of gross income are utterly immaterial if there can be no depletion allowance of any kind. The "taxable year for which the return is made" clearly means the year in which the "first return" is made. It is the year in which the taxpayer can make an election of cost or percentage depletion and in which the depletion allowance "for such year" can be computed according to the election made. In this case that year was 1935, when the property produced net income.

This view is supported by consideration of the term "depletion *allowance*", as used in Section 114 (b) (4) of the Revenue Act of 1934. This may be an allowance for cost depletion, which is intended to return to the taxpayer the cost or other basis of the mine. Or it may be an allowance for percentage depletion, computed in accordance with Section 114 (b) (4). But there must be "depletion *allowance* for such property for the taxable year for which the return is made." Otherwise the taxpayer cannot state whether he elects to have the "depletion allowance" computed with or without regard to percentage depletion; the "depletion allowance" for the year cannot be computed in any way, let alone "according to the election thus made"; and the "depletion allowance . . . for such year" cannot be computed without reference to percentage depletion.

The percentage allowance for metal mines is fixed at 15 percentum of the gross income from each property for the taxable year, less rents or royalties paid or incurred. But gross income is only one of two coordinate factors in the computation of percentage depletion. The other is the net income from the mine. The allowance for depletion may

not exceed fifty percentum of the net income computed without allowance for depletion. Thus there can be no allowance for percentage depletion unless there is net as well as gross income. The one is as basic as the other. Without net income, there can be no "depletion allowance" computed with regard to the percentage method. If the taxpayer has exhausted cost depletion, there can be no "depletion allowance" of any kind. And if there can be no "depletion allowance" at all, the Act has no application.

It follows, therefore, that the petitioner's return for 1934 was not the "first return" under the Act. For although it was "in respect of a property" within Section 114 (b) (4), it was not one in which the petitioner could elect to have the "depletion allowance . . . for the taxable year" computed with or without reference to percentage depletion. The petitioner had no election in the taxable year 1934. It had already exhausted its cost depletion, and it could have no percentage depletion because it had no net income for the year without allowance for depletion. Not until the 1935 return did the petitioner have any election. Not until then could it have a "depletion allowance . . . for the taxable year for which the return is made . . .". Then only could the allowance be computed with or without reference to percentage depletion. The 1935 return was the "first return" under the Act. See *Haggar Co.* v. *Helvering*, 308 U. S. 389, where this Court said (p. 395):

> "First return thus means a return for the first year in which the taxpayer *exercises the privilege* of fixing its capital stock value for tax purposes." (Italics supplied).

This interpretation of the Act, we maintain, is the only reasonable one. It attaches meaning to all of the statutory language. Furthermore, this construction accords with the well defined principle that a true election, which Congress clearly intended, presupposes the existence of the right of choice between two alternatives. *Standard Oil Co.* v. *Haw-*

kins, 74 Fed. 395 (C. C. A. 7th); *Patent Royalties Corporation* v. *Commissioner*, 65 F. (2d) 580 (C. C. A. 2d); *McIntosh* v. *Wilkinson*, 36 F. (2d) 807 (D. C. Wis.); *Dexter Sulphite Pulp & Paper Co.* v. *Commissioner*, 23 B. T. A. 227, 235. See also *Snow* v. *Alley*, 156 Mass. 193, 30 N. E. 691, 692; *Allis* v. *Hall*, 76 Conn. 322, 56 Atl. 637, 644.

Finally, the construction we urge not only gives meaning to the entire section, but also carries out the obvious purposes of Congress. The primary purpose was to grant the taxpayer the right to percentage depletion; the secondary purpose, to permit him to make an irrevocable choice between percentage and cost depletion for a particular year and succeeding years. The grant was liberal. The petitioner should not be deprived of a tax benefit which Congress deliberately bestowed on owners of coal, metal and sulphur mines. If there were any doubt as to the meaning of Section 114 (b) (4), it should be read in the light of what Congress was seeking to accomplish—a grant to mine owners of the right to percentage depletion and an election between it and cost depletion. The decision below is clearly contrary to the evident meaning of the act taken as a whole, and should be rejected.

Only the decision below is contrary to our contention. In a carefully reasoned and to our minds conclusive opinion by Judge Goodrich, the Third Circuit made a decision squarely supporting the argument here made. *Pittston-Duryea Coal Co.* v. *Commissioner*, 117 F. (2d) 436. There, as here, the mine owner had a net loss in 1934 from its mining property, without any allowance for depletion. There, as here, it had no right to cost depletion that year. The Commissioner contended there, as here, that the failure to make an election in the 1934 return precluded percentage depletion in a subsequent year. But the Circuit Court of Appeals for the Third Circuit decided against this contention. Judge Goodrich said:

> ". . . We think it would be an absurd result to construe this statute to require the taxpayer to choose a

method of depletion and to state the method when there is nothing from which to make the deduction.

"Two purposes are clearly evident in the section under consideration. The first is to give to the taxpayer the choice of electing the method of computing its depletion allowance in a particular year. The second is to hold him to that method in succeeding years. The point is that primarily the taxpayer is to have an election as to the computation of its depletion allowance. The second result flows from the first.

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"Regardless of what may be the situation in higher mathematics, one may not in making an income tax return use the subtrahend of deduction unless he has a minuend of net income from which to subtract it. Since the taxpayer in this case could not have had a deduction in 1934 under either method, it cannot be said to have made an election, which consists of a choice of alternatives. In this election there were no candidates, for there was no original cost, and no profit on which a deduction could be taken. It will be noted that the word 'elects' in the statute is used with reference to 'the depletion allowance for such property for the taxable year.' It seems to us that the common sense effect of this provision is that the choice was to be made at a time when there could be a depletion allowance. *The words 'first return' must be read in the light of these considerations and, so read, we think the reasonable meaning is that the taxpayer must make its choice in the first taxable year in which it could have a depletion allowance under one of the methods of computation.*" (Italics supplied.)

The Board originally tended to support the Commissioner, but it has since changed its views. See *Walter C. Hill*, 41 B. T. A. 245, at 246; *Tonopah Mining Co.* v. *Commissioner*, 44 B. T. A. 165, at 168, aff'd, 127 F. (2d) 239 (C. C. A. 3d). In the latter case, the Board said (168):

"If the petitioner had had no net income for 1934 or 1935 it would not have been incumbent upon it to make an election with regard to percentage depletion for either year."

Riley Investment Co. v. *Commissioner*, 311 U. S. 55, does not touch the issue in this casee. There the taxpayer had a net profit in 1934 and it conceded that it was obliged to state its election of percentage depletion in its 1934 return. It asked to be excepted from the operation of the statute because of its excusable ignorance of the right to use the percentage method. We ask for no exception. We request only that the statute be given its palpable meaning.

B. The administrative construction of Section 114 (b) (4) is entitled to no weight.

Section 114 (b) (4) of the Revenue Act of 1934 is dealt with in the issue here involved in Treasury Regulation 86, Article 23 (m)-5 (*infra*, p. 20). By that Article, the taxpayer is required in his first return for a taxable year beginning after December 31, 1933 to "state as to each property with respect to which the taxpayer has *any item of income or deduction* whether he elects to have the depletion allowance for each such property for the taxable year computed with or without reference to depletion allowance." (Italics supplied.) The lower court held the regulation to be a reasonable construction of Section 114 (b) (4). We respectfully submit the court erred; first, because the statute is unambiguous and requires no gloss by the Commissioner, and secondly, because the regulation is clearly contrary to the intendment of the Act.

The lower court approached the statute as one which was phrased in general terms and was therefore an appropriate subject for interpretative administrative regulation. *Helvering* v. *Reynolds Tobacco Co.*, 306 U. S. 110, 114, was cited as authority for this purpose. We do not, of course, question the decision in the *Reynolds Co.* case; indeed, we believe that the decision shows clearly the difference between statutes which are "general" and those which are not. The Court was there dealing with a section of the Revenue Act (Sec. 22(a), Revenue Act of 1928, c. 852, 45 Stat. 791) which defined gross income as including "gains or profits

and income derived from any source whatever." No one can doubt that such language is indeed "general." On the other hand, as we have shown above, Section 114 (b) (4) is completely specific. Congress made very clear what it meant by the "first return" in which the taxpayer was to state whether he elected cost or percentage depletion. Thus, the interpretation set forth in Article 23 (m)-5 is wholly unnecessary, and, by the same token, wholly ineffective, since it is well settled that administrative construction will be resorted to only in the event that the statute is general and ambiguous. *Louisville & Nashville Ry.* v. *United States*, 282 U. S. 740, 757; *Koshland* v. *Helvering*, 298 U. S. 441, 446; *Biddle* v. *Commissioner*, 302 U. S. 573, 582; *Helvering* v. *Oregon Mutual Life Insurance Co.*, 311 U. S. 267, 272.

Moreover, and an additional reason for ignoring the Article, is that the administrative construction which is embodied in it is patently contrary to the obvious intention of Congress. We have already shown, in Part A, the legislative will as reflected in the statutory language itself. We now consider the external evidence of Congressional intent.

It may not be inappropriate, before we consider this evidence, to point out that the Treasury, of which the Commissioner is part, has demonstrated unmistakable hostility to percentage depletion for mining properties. See *Hearings Before House Committee on Ways and Means on Revenue Revision, 1934*, 73d Cong., 2d Sess., p. 25; *Hearings Before House Committee on Ways and Means on Revenue Revision of 1942*, 77th Cong., 2d Sess., pp. 8-9; *Hearings Before Senate Committee on Finance on H. R. 7378*, 77th Cong., 2d Sess., pp. 5-6 (Revenue Revision, 1942). In view of these efforts to dislodge percentage depletion for mines from the tax laws, it is not surprising that the Treasury has construed Section 114 (b) (4) in an unduly restrictive manner.

There is nothing in the statute itself which justifies the administrative construction. Article 23 (m)-5 of Treasury Regulation 86 is ambiguous. The Commissioner did not

specify whether by "item of income" he meant gross or net income. This by itself is sufficient reason for setting aside the regulation. *Burnet* v. *Chicago Portrait Co.*, 285 U. S. 1, 16; *Estate of Sanford* v. *Commissioner*, 308 U. S. 39, 49. But we shall assume for the purposes of this argument that the Commissioner intended "income" to refer to gross income. Had Congress intended to require taxpayers to make their election in the first return which reported gross income, it would have said exactly that. In fact, however, Congress used specific language requiring all taxpayers to state their election in the "first return" in which an election was actually available. In view of the definition of the allowance for percentage depletion and the requirements that the taxpayer shall elect whether "the depletion allowance . . . for the taxable year for which the return is made" should be computed with or without regard to percentage depletion and that "the depletion allowance . . . for such year" shall be computed according to the election thus made, no election between cost and percentage depletion is possible until the taxpayer has net income from the mining property. Not until then can the "depletion allowance" for the year of the "first return" be computed according to the election made. The statute is as simple as that. Nor does this construction involve administrative difficulties, as the lower court seemed to think. Taxpayers who had elected percentage depletion would undoubtedly refer to that year of their election in their returns. See R. 12, 15, 55. In any event, all the respondent need do is to check the depletion taken as against the return of the previous year. See *Tonopah Mining Co.* v. *Commissioner*, 127 F. (2d) 239, at 244 (C. C. A. 3d). In fact, it is established practice for the Commissioner to check the return in the previous year. *Welch* v. *Schweitzer*, 106 F. (2d) 885, 887 (C. C. A. 9th). See Exhibit 5, R. 67-73, especially at 70, 72.

The repeated construction of the nearly identical language in the Revenue Acts of 1936, 1938, and 1940 is wholly

irrelevant. There was no occasion for Congress to correct the administrative construction until the decision in this case. As Judge Learned Hand stated in *F. W. Woolworth Co.* v. *United States*, 91 F. (2d) 973, at 976 (C. C. A. 2d), certiorari denied, 302 U. S. 768, "To suppose that Congress must particularly correct each mistaken construction under penalty of incorporating it into the fabric of the statute appears to us unwarranted; our fiscal legislation is detailed and specific enough already." No case under Section 114 (b) (4) of the Revenue Act of 1934 reached the courts until January, 1941. The first judicial decision, *Pittston-Duryea Coal Co.* v. *Commissioner*, 117 F. (2d) 436, *supra*, rightly ignored the restrictive interpretation of the Commissioner in Treasury Regulation 86 and followed the evident intent of Congress. Therefore, there was no need for Congress to deal with this subject until the contrary decision of the court below in February, 1942. See Paul, *Studies in Federal Taxation, Third Series* (1940) 433. When the conflict between the circuits arose, the matter was brought before the Congressional Committees and Congress itself.

In the preparation of the 1942 Revenue Act, Representative Wesley E. Disney, a member of the House Ways and Means Committee, offered an amendment concerning percentage depletion for mines which would permit the taxpayers to make a new election. His amendment and the reasons for it are most significant. The amendment was as follows:

> "The third sentence of section 114 (b) (4) of the Internal Revenue Code is amended by striking out after the word 'chapter' the words 'in respect of a property,' and substituting in lieu thereof the following: 'in which depletion is claimed in respect of a property for a taxable year beginning after December 31, 1941 (whether or not a return in respect of such property was made for any taxable year beginning prior to January 1, 1942)'." (Hearings Before House Committee on Ways and Means on Revenue Revision of 1942, 77th Cong., 2d Sess., p. 3489).

This language would show unmistakably that the election must be made in the first return in which *depletion is claimed*, i.e., when a claim for depletion is possible due to the existence of net income.

The reason given by Congressman Disney for his amendment is also directly pertinent to the issue in this case:

> "*Many taxpayers have been deprived of the right to take percentage depletion which Congress intended.* This situation has arisen for the following reasons, among others:
>
> • • • • • • • • • •
>
> "(3) Confusion has also arisen in the past as to the proper year for making the election because of uncertainty as to whether an election had to be made on a return which showed no net income from the property. Many taxpayers assumed that the 'first return' from the property was the first one which showed net income and which required a depletion computation, and hence failed to make an election in case the property showed a loss. The Treasury, on the other hand, held that an election must be made whether or not there was net income from the property. By failing to make the election in the year specified by the Treasury, many such taxpayers have been debarred from their right to percentage depletion. *It is believed that the intention of Congress, when the expression 'first return' was used, was to mean the first return on which depletion was claimed. The language of the amendment above suggested clarifies this original intent.*" (*Id.*, Italics supplied).

In the bill introduced by Chairman Doughton of the House Committee on July 14, 1942 (H. R. 7378, 77th Cong., 2d Sess.) it was provided in Section 131 that Section 114 (b) (4) of the previous statute be repealed, and that there should be an outright grant of percentage depletion. In the report accompanying the bill, the Committee explained:

> "For taxable years beginning after December 31, 1941, the depletion deduction for coal, fluorspar, metal, and sulphur mines may be computed (without regard to

any election) either on the percentage basis or on the cost basis, whichever gives the greater deduction." (H. R. No. 2333, 77th Cong., 2d Sess., p. 92).

This provision was retained in the Senate draft (though the number of the section was changed from 131 to 147). The Senate Report (S. Rep. No. 1631, 77th Cong., 2d. Sess., p. 115) contained the same explanation as that given by the House Committee, quoted above. This provision became law on October 21, 1942.

The intention of Congress, had it been doubtful in the statute itself, is now crystal clear. At all times it intended to require the election in the first return under the 1934 Act in which the taxpayer reported net income, and thus had an actual opportunity to state a preference between cost and percentage depletion. Nor can it be argued that by the amendment in the Revenue Bill of 1942, which will preclude the Treasury's construction of Section 114 (b) (4) in the future, Congress has also declared that for prior years the construction in Article 23 (m)-5 is to govern. A precisely similar argument was rejected in *Haggar Co.* v. *Helvering*, 308 U. S. 389, 398-400. *Accord: United States* v. *Hutcheson*, 312 U. S. 219, 235-36.

CONCLUSION.

This case forcefully demonstrates the impropriety, inequity and hardship resulting from the respondent's construction of Section 114 (b) (4) which, if upheld, prevents this taxpayer and others who followed the specific words of the statute from having the benefit of percentage depletion from 1935 to date. The respondent's narrow interpretation of the Act finds no sanction in its language, history or declared purpose.

For the reasons given above, the petitioner submits that the judgment of the lower court should be reversed.

Respectfully submitted,

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APPENDIX.

Revenue Act of 1934, c. 277, 48 Stat. 680.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(b) Basis for Depletion.—

(4) *Percentage Depletion for Coal and Metal Mines and Sulphur.*—The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. The method, determined as above, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer, or of any other person if the basis of

the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer, either directly or through one or more substituted bases, as defined in that section.

Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23(m)-5. Computation of depletion based on a percentage of income in the case of coal mines, metal mines, and sulphur mines or deposits.—Under section 114(b)(4) a taxpayer may deduct for depletion an amount equal to 5 per cent of the gross income from the property during the taxable year in the case of coal mines, an amount equal to 15 per cent of the gross income from the property during the taxable year in the case of metal mines, and an amount equal to 23 per cent of the gross income from the property during the taxable year in the case of sulphur mines or deposits, but such deduction shall not in any case exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. (For definitions of "gross income from the property" and "net income of the taxpayer (computed without allowance for depletion) from the property," see article 23(m)-1 (g) and (h).)

In his first return made under Title I of the Act (for a taxable year beginning after December 31, 1933) the taxpayer must state as to each property with respect to which the taxpayer has any item of income or deduction whether he elects to have the depletion allowance for each such property for the taxable year computed with or without reference to percentage depletion. An election once exercised under section 114(b)(4) and this article can not thereafter be changed by the taxpayer, and the depletion allowance in respect of each such property will for all succeeding taxable years be computed in accordance with the election so made. If the taxpayer fails to make such statement in the return in which the election should be so indicated, the depletion allowance for the year for which an election must be first exercised and for all succeeding taxable years will be computed without reference to percentage depletion. The method, determined under section 114(b)

(4) and this article, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer, or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer, either directly or through one or more substituted bases, as defined in that section.

Revenue Act of 1932, c. 209, 47 Stat. 169.

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(b) Basis for Depletion—

(4) *Percentage Depletion for Coal and Metal Mines and Sulphur.*—The allowance for depletion shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance for the taxable year 1932 or 1933 be less than it would be if computed without reference to this paragraph. A taxpayer making return for the taxable year 1933 shall state in such return, as to each property (or, if he first makes return in respect of a property for any taxable year after the taxable year 1933, then in such first return), whether he elects to have the depletion allowance for such property for succeeding taxable years computed with or without reference to percentage depletion. The depletion allowance in respect of such property for all succeeding taxable years shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for succeeding taxable years shall be computed without reference to percentage depletion.

Regulations 77, promulgated under the Revenue Act of 1932:

ART. 225. Computation of depletion based on a percentage of income in the case of coal mines, metal mines, and sulphur mines or deposits.—

* * *

In the return for the taxable year 1933 the taxpayer must state as to each property whether he elects to have the depletion allowance for each property for 1934 and succeeding taxable years computed with or without reference to percentage depletion. In the case of any property in respect of which a return is first made by the taxpayer in a year subsequent to 1933, the taxpayer must state as to each property whether he elects to have the depletion allowance for succeeding taxable years computed with or without reference to percentage depletion. An election once exercised under section 114(b)(4) and this article can not thereafter be changed by the taxpayer, and the depletion allowance in respect of each such property will for all succeeding taxable years be computed in accordance with the election so made. If the taxpayer fails to make such statement in the return in which the election should be so indicated, the depletion allowance for the year for which an election must be first exercised and for all succeeding taxable years will be computed without reference to percentage depletion.